

D.T.E. 03-3

Petition of Southern Union Company for approval and authorization pursuant to G.L. c. 164 § 17A, to invest up to \$662.3 million in Southern Union Panhandle Corporation; and pursuant to G.L. c. 164, §§ 14 and 16, to issue common and/or preferred stock up to an aggregate value of \$300 million.

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FOR: SOUTHERN UNION COMPANY
Petitioner

I. INTRODUCTION

On January 15, 2003, Southern Union Company (“Southern Union” or “Company”) filed a petition with the Department of Telecommunications and Energy (“Department”) for approval and authorization pursuant to G.L. c. 164, § 17A, to invest up to \$662.3 million in Southern Union Panhandle Corporation (“Southern Union Panhandle”); and pursuant to G.L. c. 164, §§ 14 and 16, to issue common and/or preferred stock up to an aggregate value of \$300 million.¹ No one petitioned to intervene. The Department docketed the filing as D.T.E. 03-3.

Pursuant to notice duly issued, the Department conducted public and evidentiary hearings at the Department’s offices on January 28, 2003. In support of its petition, the Company offered the testimony of David J. Kvapil, chief financial officer for Southern Union. The evidentiary record consists of 27 exhibits and 11 responses to record requests. On February 5, 2003, the Company submitted a brief in support of its petition.

II. DESCRIPTION OF THE COMPANY’S PROPOSAL

A. Description of the Investment

Southern Union seeks approval and authorization, pursuant to G.L. c. 164, § 17A, to invest up to \$662.3 million in Southern Union Panhandle. On December 21, 2002, Southern Union entered an arrangement with AIG Highstar Capital, L.P. (“AIG Highstar”) and AIG Highstar II Funding Corp. (“AIG Funding”), a private equity fund sponsored by American International Group, Inc., to invest in a new business entity, Southern Union Panhandle.

¹ On September 28, 2000, Southern Union, a Delaware corporation, acquired North Attleboro Gas Company and Fall River Gas Company. North Attleboro Gas Company and Fall River Gas Company operate in Massachusetts subject to the Department’s jurisdiction pursuant to G.L.c. 164, § 1, under a d/b/a name “New England Gas Company”.

Southern Union Panhandle will acquire Panhandle Eastern Pipe Line Company (“Panhandle Eastern”), which is currently owned by CMS Gas Transmission Company (“CMS”).²

Under the terms of a Letter Agreement and Stock Purchase Agreement, Southern Union will acquire an equity interest in Southern Union Panhandle, which will purchase the interstate pipeline distribution operations of Panhandle Eastern (Exh. SU-2; Company Brief at 4).³ To complete the transaction, Southern Union Panhandle will acquire from CMS all of the issued and outstanding shares of Panhandle Eastern (Exhs. SU-1, at 4; SU-2). The total consideration to be paid by Southern Union Panhandle for these shares is approximately \$662.3 million in cash and the assumption of Panhandle Eastern’s debt in the amount of approximately \$1.17 billion (Exhs. SU-1, at 2-4; SU-7).

To fund this transaction, Southern Union will invest up to \$512 million in Southern Union Panhandle and AIG Highstar will invest up to \$150 million. As a result of this

² Panhandle Eastern is a “natural gas company” as defined in Section 2 of the Natural Gas Act (15 U.S.C. § 717) and is subject to all rules and regulations promulgated by the Federal Energy Regulatory Commission. Panhandle Eastern is engaged in the interstate transportation and storage of natural gas and the storage and re-gasification of liquefied natural gas (“LNG”) (Exh. SU-1, at 6). Panhandle Eastern operates a network of almost 11,000 miles of mainline natural gas pipeline facilities extending from the Gulf of Mexico to the Midwest United States and Canada (id.). The Panhandle Eastern pipelines have a combined peak-day delivery capacity of 5.4 billion cubic feet, 88 billion cubic feet of underground storage capacity and 6.3 billion cubic feet of above-ground LNG storage facilities (id.).

³ The Company has testified that it is acquiring Panhandle Eastern at a price that is significantly lower than the price paid in 1999 by the current owner, and that is likely priced below its long-term value because of an influx of high-quality pipeline assets to the market (Exhs. SU-6; SU-13; Company Brief at 15). Southern Union Panhandle will acquire the Panhandle Eastern assets for approximately \$1.8 billion in cash and the assumption of debt, as compared to the \$2.2 billion that CMS paid for the same assets in 1999 (Exhs. SU-6; SU-13).

transaction, Southern Union Panhandle will be jointly owned by Southern Union (owning approximately 77.9 percent) and AIG Highstar (owning approximately 22.1 percent) (Exh. SU-1, at 5-6; Tr. at 4). Southern Union will hold all of Southern Union Panhandle's voting shares, and AIG Highstar and AIG Funding will have the right to acquire a non-voting equity interest in Southern Union Panhandle (Exh. SU-1, at 5).

Although Southern Union's anticipated ownership in Southern Union Panhandle will be approximately 77.9 percent, Southern Union requests authorization to invest the full purchase price of Panhandle Eastern for \$662.3 million. Southern Union offers two reasons for doing so.

First, Southern Union seeks to structure the transaction as to enable a "like-kind" exchange for federal income tax purposes, with Panhandle Eastern's shares first transferred to a qualified intermediary and then from the intermediary to Southern Union Panhandle (Exhs. SU-1, at 9; SU-15; Tr. at 37-40). The Company explained that to qualify as a like-kind exchange under the Internal Revenue Service ("IRS") rules, the Company must be the initial purchaser of 100 percent of the equity interest associated with Panhandle Eastern (Exh. SU-1, at 12; Tr. at 38-40). Pursuant to the Stock Purchase Agreement, Southern Union has "guaranteed" the performance of AIG Funding, which together with Southern Union, is responsible for providing up to 96.3 percent of the purchase price (Exhs. SU-1, at 12; SU-2). The Company stated that the guarantee is a necessary component of the overall transaction because it enables and maintains the like-kind exchange under the IRS rules (id.).

Second, Southern Union is guaranteeing the participation of AIG Highstar to CMS so that the transaction may be completed in the event that AIG Highstar were to lessen its

participation in the transaction prior to closing (Exh. SU-1, at 13; Tr. at 4). The Company states that the guarantee is consistent with general practice in joint venture transactions where one partner typically ensures the seller that funding will be available to complete the sale (id.). Here, Southern Union is providing a guarantee of the financial performance of AIG Funding both to enable the like-kind exchange and to assure the seller that the transaction will be completed (id.).

Southern Union will fund its portion of the investment in Southern Union Panhandle with approximately \$420 million generated from the sale of its Texas operations (Exh. SU-1, at 13; Tr. at 4). The remainder of its share of the investment, up to approximately \$100 million, will be funded by using available resources, including short-term debt (Exh. SU-1, at 1).

The Company states that the \$1.17 billion in Panhandle Eastern debt to be assumed is non-recourse, meaning that the holders of the debt will have no recourse to either Southern Union Panhandle or Southern Union (Exh. SU-7; Tr. at 14-15). The Company states that none of Southern Union's assets, including its local gas distribution assets, or any assets held by Southern Union Panhandle, may be attached by Panhandle Eastern debt holders to satisfy the debt obligations in the event that there is a default on the Panhandle Eastern debt instruments (Exh. SU-7; Tr. at 14; RR DTE-2). Moreover, the Company states that none of Southern Union's utility assets and operations will be used to provide security to the Panhandle Eastern lenders (id.).

B. Stock Issuance

Southern Union seeks approval and authorization, pursuant to G.L. c. 164, §§ 14 and

16, to issue shares of common and/or preferred stock with an aggregate value of up to \$300 million for the purpose of retiring long-term debt, funding utility operations, and improving its capital structure (Exhs. SU-1, at 15; SU-11; SU-26; Tr. at 32). The Company represents that the stock issuance is an integral and necessary part of the Company's plan to acquire the Panhandle Eastern assets (Tr. at 38-39, 43-47; Company Brief at 3). Southern Union states that the need for a stock issuance stems from discussions with financial analysts regarding the Company's investment in Southern Union Panhandle and the acquisition of Panhandle Eastern (Tr. at 7). The Company states that in order to achieve more favorable capitalization ratios following the transaction, and in order for the transaction to be well-received by the investment community, the issuance of additional equity and the repayment of long-term debt is necessary (Exhs. SU-1, at 15; SU-8; SU-20; SU-25; Tr. at 7). Further, the Company states that it plans to use the proceeds from the stock issuance primarily for repayment of indebtedness and the redemption of existing preferred securities (Exhs. SU-1, at 15; SU-8; SU-20; SU-25; Tr. at 7).

Southern Union is currently working with its investment bankers to determine how to best structure the issuance to achieve this goal while taking maximum advantage of market conditions (Exh. SU-8; Tr. at 49-51). The Company has indicated that the likely composition of the issue will be 50 percent (or \$150 million) in common stock and 50 percent (or \$150 million) in preferred securities (Exh. SU-10; Tr. at 12-13; SRR DTE 2-1). The Company testified that because the final composition of the issuance will be influenced by market conditions, investor feedback, and general economic and political conditions, the actual details of the stock issuance may not be determined until days or hours before the offering, and may vary from the Company's above estimates by as much as approximately \$50 million (Exh.

SU-10; Tr. at 12-13, 50-51; SRR DTE 2-1). The Company also stated that it anticipates that the issuances will be completed within six months of the closing of the transaction (id.).

For the proposed common stock issuance, the Company anticipates a minimum offering price of \$10.00 per share, with a par value of \$1.00 per share (SRR DTE 2-2). The current share price of Southern Union is \$13.89 per share (id.).⁴ The Company asserts that, assuming the minimum price of \$10.00 per share, it would issue 1.8 million shares of common stock to obtain \$200 million in net proceeds (id.).⁵

With respect to the preferred securities, the Company intends to issue one or more of three forms of preferred stock: (1) trust originated preferred securities/redeemable preferred stock; (2) “straight” preferred stock; or (3) mandatory convertible preferred stock (Exh. SU-18; Tr. at 9-12). By issuing a combination of types of preferred stock, in conjunction with common stock, the Company states that it may take advantage of current market conditions and meet its projected capitalization goals over the next several years (Tr. at 10). Although the Company has not yet determined the details as to the price, size and timing of the preferred securities issuance, the Company has provided an anticipated range of values (SRR DTE 2-2; SRR DTE 2-3; SRR DTE 2-4).

The Company anticipates that the new trust-originated preferred securities would have a maturity date of up to 30 years and would be callable, at the Company’s option, at a point at least five years from the date of issuance (SRR DTE 2-3). The new issuance would also most likely include a 10-year extension option, exercisable at the Company’s option (id.). The

⁴ As of the market close on February 13, 2003.

⁵ The correct calculation appears to be an issuance of 20 million common shares issued at \$10 per share resulting in cash proceeds of \$200 million.

anticipated dividend rate on the issue would be 7.5 to 9.5 percent, with dividends to be paid quarterly (id.). In terms of pricing, the shares would have zero par value and are likely to possess an offering price ranging from \$5.00 to \$25.00 (id.).

With respect to the traditional or “straight” preferred issuance, the Company has provided an anticipated range of values for the potential offering (SRR-DTE-2-4). The maturity date of the issue is anticipated to be at least five years and would be callable, at the Company’s option, after five years (id.). The anticipated dividend rate on the issue would be between 4.5 and 8.5 percent, with dividends to be paid quarterly (id.). In terms of pricing, the shares have no par value and the Company anticipates that the minimum offering price would be no less than \$5.00 per share (id.).

With respect to mandatory preferred securities, the maturity or conversion date will be dependent upon the date, designated point in time, or designated event upon which the security converts into common stock and the conversion date ranges from two-five years (SRR-DTE-2-5). The anticipated dividend rate on the issue would be between 4.5 and 8.5 percent, with dividends to be paid quarterly or annually (id.). In terms of pricing, these shares have no par value and the Company anticipates that the minimum offering price would be no less than \$10.00 per share (id.).

III. STANDARD OF REVIEW

A. Section 17A Investment

Pursuant to G.L. c. 164, § 17A, a gas or electric company must obtain written Department approval in order to “loan its funds to, guarantee or endorse the indebtedness of, or invest its funds in the stock, bonds, certificates of participation or other securities of, any corporation, association or trust” The Department has indicated that such proposals must be “consistent with the public interest,” that is, a § 17A proposal will be approved if the public interest is at least as well served by approval of the proposal as by its denial.

Massachusetts Electric Company, D.T.E. 01-104, at 4 (2002) citing Bay State Gas Company, D.P.U. 91-165, at 7 (1992); see Boston Edison Company, D.P.U. 850 (1983).

The Department has stated that it will interpret the facts of each § 17A case on its own merits to make a determination that the proposal is consistent with the public interest. Id.; D.P.U. 91-165, at 7. The Department will base its determination on the totality of what can be achieved rather than a determination of any single gain that could be derived from the proposed transactions. Id.; see D.P.U. 850, at 7. The Department also found that the public interest standard best accommodates the Department’s interest in protecting the utility’s ratepayers from the adverse effects of unwarranted § 17A transactions and a utility’s interest in having flexibility in a changing marketplace to meet long term objectives of its ratepayers and shareholders. Id. at 5; D.P.U. 91-165, at 7; Boston Edison Company, D.P.U. 97-17, at 6 (1997).

Thus, the Department’s analysis must consider the overall anticipated effect on ratepayers of the potential harms and benefits of the proposal. Id. at 5; D.P.U. 91-165, at 8.

The effect on ratepayers may include consideration of a number of factors, including, but not limited to: the nature and complexity of the proposal; the relationship of the parties involved in the underlying transaction; the use of funds associated with the proposal; the risks and uncertainties associated with the proposal; the extent of regulatory oversight on the parties involved in the underlying transaction; and the existence of safeguards to ensure the financial stability of the utility. Id. at 5.

B. Section 14 Stock Issuance

In order for the Department to approve the issuance of stocks, bonds, coupon notes, or other types of long-term indebtedness⁶ by an electric or gas company, the Department must determine that the proposed issuance meets two tests. First, the Department must assess whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) (“Fitchburg II”) citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) (“Fitchburg I”). Second, the Department must determine whether the Company has met the net plant test.⁷ Colonial Gas Company, D.P.U. 84-96 (1984); Colonial Gas Company, D.P.U. 84-96 (1984); see also Milford Water Company, D.P.U. 91-257, at 4-5 (1992); Edgartown Water Company, D.P.U. 90-274, at 5-7 (1990); Barnstable Water Company, D.P.U. 90-273, at 6-7 (1990).

⁶ Long-term refers to periods of more than one year after the date of issuance. G.L. c. 164, § 14.

⁷ The net plant test is derived from G.L. c. 164, § 16.

The Supreme Judicial Court has found that, for the purposes of G.L. c. 164, § 14, “reasonably necessary” means “reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency.” Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946). In cases where no issue has been raised about the reasonableness of management decisions regarding the requested financing, the Department limits its Section 14 review to the question of whether proceeds from an issuance will be used for a purpose that, on its face, is reasonable. Bay State Gas Company, D.T.E. 02-73, at 12 (2003); Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990).

The Fitchburg I and II and Lowell Gas cases also established that the burden of proving that an issuance is reasonably necessary rests with the company proposing the issuance, and that the Department's authority to review a proposed issuance "is not limited to a 'perfunctory review.'" Fitchburg I at 678; Fitchburg II at 841, citing Lowell Gas at 52.

Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

Where issues concerning the prudence of the Company's capital financing have not been raised or adjudicated in a proceeding, the Department's decision in such a case does not represent a determination that any specific project is economically beneficial to a company or

to its customers. In such circumstances, the Department's determination in its Order may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing. See, e.g., Boston Gas Company, D.P.U. 95-66, at 7 (1995).

Accordingly, the Department has determined that petitions filed under G.L. c. 164, § 14 will be approved if the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations and the company has met the net plant test, derived from G.L. c. 164, § 16.

IV. CAPITAL STRUCTURE OF THE COMPANY

As of September 30, 2002, Southern Union's utility plant (including \$22,118,000 in construction work in progress ("CWIP")) was \$2,301,116,000 (Exh. SU-4). After removing \$838,741,000 in accumulated depreciation and amortization, the Company reported a net utility plant of \$1,462,375,000 (id.). In addition, Southern Union had \$139,193,000 of gas inventories (id.). Thus, as of September 30, 2002, the Company had a net utility plant and gas inventory balance of \$1,601,568,000 (id.).

As of September 30, 2002, the Company reported a total capitalization of \$1,927,312,000, consisting of (1) \$1,147,395 in long-term debt; (2) \$100,000,000 in preferred securities of a subsidiary trust, and (3) \$679,917,000 in common equity, which included a negative retained earnings balance of \$6,495,000 (id.).

Southern Union proposed a number of adjustments to these capitalization and net utility plant balances (Exh. SU-4). First, the Company excluded \$301,007,000 (\$536,424,000 in plant less \$235,417,000 in accumulated depreciation and less \$9,709,000 in CWIP), plus gas

inventories of \$7,161,000 from net plant in service to remove plant associated with the sale of the Company's Texas operating division to ONEOK, Inc. (Exhs. SU-1, at 2; SU-4). Secondly, the Company excluded \$21,887,000 (\$16,340,000 in plant, less accumulated depreciation of \$1,691,000, plus gas inventories of \$7,238,000) from plant in service to remove plant associated with unregulated operations (Exh. SU-4). The Company then made a corresponding reduction of \$21,887,000 to its total capitalization, based on a pro rata reduction to long-term debt, preferred securities, and premiums on common stock (Exh. SU-4).⁸ Third, the Company excluded \$642,921,000 associated with acquisition premiums, representing the excess of the purchase price over book value of several natural gas utilities acquired in recent years (id.).⁹ Fourth, the Company excluded from capitalization a negative balance in retained earnings of \$6,495,000 (id.). The Company then eliminated an additional \$12,409,000 in CWIP associated with its non-Texas operations from its property, plant and equipment accounts (id.). As a result of these adjustments, the Company's property, plant and equipment and the Company's total capitalization prior to the acquisition of Panhandle Eastern amounted to \$1,259,104,000 and \$1,276,237,000, respectively.¹⁰

⁸ The Company's unregulated operations have been supported over the years through a combination of debt and equity (Exh. SU-1, at 12-13).

⁹ The Company stated that it has financed its acquisitions over the years through a combination of debt and equity and cannot directly attribute the acquired facilities to specific capital sources (Exh. SU-1, at 12-13).

¹⁰ The net plant balance as of September 30, 2002 of \$1,601,568,000 minus the net book value of the Texas properties sold of \$308,168,000, less the net Southern Union adjustments of \$34,296,000, equals \$1,259,104,000. The total capitalization as of September 30, 2002 of \$1,927,312,000, less the net Southern Union adjustments of \$651,075,000, equals \$1,276,237,000.

The Company next proposed adjustments to include: (1) the acquisition of Panhandle Eastern by Southern Union Panhandle; (2) the consolidation of Southern Union Panhandle's balance sheet with that of Southern Union; (3) the proposed issuance of \$300 million of preferred and/or common equity; and (4) the retirement of \$300 million in long-term debt resulting from the stock issuance (Exh. SU-1, at 23). To record the acquisition, Southern Union increased its net plant in service by \$1,847,100,000 (including gas inventories of \$61,000,000), increased its long-term debt by \$1,167,000,000, representing the amount assumed by Southern Union Panhandle as part of the transaction, and increased its common equity by \$662,300,000, representing the investment by Southern Union and AIG Highstar in Southern Union Panhandle (Exh. SU-4). The Company next decreased its common equity by \$512,300,000, representing its investment in Southern Union Panhandle¹¹, and increased its common equity by the \$300,000,000 proposed stock issuance (id.). The Company then increased its long term-debt by \$92,300,000, the amount of the investment in Southern Union Panhandle financed with debt, and decreased its long-term debt by \$300,000,000, representing its anticipated use of the proceeds of the proposed stock issuance (id.). Finally, the Company reduced its Southern Union Panhandle property, plant and equipment by CWIP of \$39,000,000 (id.). After these adjustments, the Company's adjusted utility plant amounted to \$3,067,204,000, which is \$381,667,000 more than its adjusted capitalization of \$2,685,537,000 (id.).

¹¹ This adjustment is required to consolidate the balance sheets of Southern Union and Southern Union Panhandle.

V. ANALYSIS AND FINDINGS

A. Investment in Southern Union Panhandle

The Department's review of an investment must consider the overall anticipated effect on ratepayers of the potential harms and benefits of the proposal and may include consideration of a number of factors including, but not limited to: the nature and complexity of the proposal; the relationship of the parties involved in the underlying transaction; the use of funds associated with the proposal; the risks and uncertainties associated with the proposal; the extent of regulatory oversight on the parties involved in the underlying transaction and; the existence of safeguards to ensure the financial stability of the utility. Massachusetts Electric Company, D.T.E. 01-104, at 4 (2002), citing Bay State Gas Company, D.P.U. 91-165, at 7 (1992); see Boston Edison Company, D.P.U. 850 (1983).

Regarding potential benefits to customers, Southern Union claims that by acquiring a large asset¹² and thereby becoming a larger company, the Company will achieve operational efficiencies in providing corporate services to its operating divisions (Tr. at 20-21, 65-66). The Company states that fixed overhead costs may be allocated over a larger operation, therefore customers in Massachusetts may benefit in future rate cases because of lessened corporate overheads (Tr. at 66-67). In addition, the Company states that it will have greater purchasing power, allowing it to obtain larger nationwide discounts to purchase plant, materials and other commodities, with the benefit of the discounts accruing directly to local distribution companies (Tr. at 20-21). Based on testimony presented by the Company, the

¹² Southern Union is acquiring an interest in a business entity that is, in terms of asset value, roughly four times the size of the recently divested Texas facilities (Exh. SU-1, at 8).

Department concludes that the investment will result in operational efficiencies that benefit Massachusetts customers.

Southern Union states that it is essentially substituting the interstate pipeline facilities for the local gas distribution operations that Southern Union has conducted in Texas (Exh. SU-1, at 10). The Company states that the acquisition of Southern Union Panhandle will have no negative effect on the Company's ability to provide certain financial and corporate-management activities to its local gas distribution companies (Exh. SU-1, at 9-10). Given that Southern Union has divested its Texas operations, the Department finds that the Company has sufficient resources so that its local gas distribution companies would not lose access to financial and management resources through the acquisition of Panhandle Eastern.

Regarding the extent of regulatory oversight on the parties, Panhandle Eastern operations are regulated by the Federal Energy Regulatory Commission ("FERC") (Exh. SU-1, at 6). The Company asserts that Panhandle Eastern, as a regulated entity, is a stable asset with very predictable rates of earnings (Tr. 59).¹³ Southern Union anticipates that Panhandle Eastern, in the first full year of operation following the acquisition will: (1) increase the Company's operating revenues by over 20 percent; (2) increase the Company's combined net earnings before interest, taxes, depreciation and amortization by over 70 percent as compared to operations during fiscal year 2002; and (3) will increase the Company's per-share book value by approximately 10 percent (Exh. SU-1, at 8). Based on testimony and record evidence presented by the Company that Panhandle Eastern, as a FERC-regulated

¹³ The Company asserts that Panhandle Eastern assets have generated a regulated rate of return of approximately 13 percent, which the Company represents is more than is allowed for local gas distribution facilities (Company Brief at 14-15).

entity, will produce predictable earnings, the Department is persuaded that the use of funds for an investment in Southern Union Panhandle is consistent with the public interest as required by § 17A.

As part of the acquisition of Panhandle Eastern, Southern Union Panhandle will assume \$1.17 billion in Panhandle Eastern debt. As noted above, the Company has stated that the Panhandle Eastern debt is non-recourse and that the holders of the debt may attach the assets of Panhandle Eastern only (Exhs. SU-1, at 2; SU-7; Tr. at 14-15). The Company is not a guarantor of Panhandle Eastern's debt, meaning that in the event of default, lenders to Panhandle Eastern will be limited to claims against the assets of Panhandle Eastern only and not entitled to claims against Southern Union (Exhs. SU-1, at 2; SU-7; Tr. at 14-15). The Department is persuaded that Southern Union's assets are adequately protected from potential claims by holders of Panhandle Eastern's debt.

Immediately following the acquisition of Panhandle Eastern, Southern Union's debt-to-equity ratio will increase from its current 63.70 percent debt to 36.30 percent equity to approximately 73 percent debt and 27 percent equity (SRR DTE 1-1; Tr. at 75). The Company states that financial analysts, rating agencies and the FERC look unfavorably on a debt level (as a percent of capitalization) that is above 65 percent (Tr. at 74). In general, so does the Department. Hingham Water, D.P.U. 15-90, at 40 (1984); see Hingham Water, D.P.U. 1118, at 11 (1983). Southern Union recognizes that given the projected debt-to-equity ratio associated with the investment in Southern Union Panhandle, the Company must take steps to improve its capital structure (Exh. SU-26; Tr. at 33, 39, 64). In order to improve its common equity ratio, the Company intends to undertake the proposed stock issuance of \$300

million (Exh. SU-26). Further, the Company anticipates raising cash from the sale of Panhandle Eastern assets that are deemed “non-core operations” and use the proceeds for debt reduction (Exh. SU-26). In addition, the Company states it will use cash flow from Panhandle Eastern operations to reduce debt (Exh. SU-26).¹⁴ Given the Company’s plan to improve its debt-to-equity ratio, the Department recognizes that the steep rise in the Company’s debt level is transient and would be remedied through the combination of an equity issuance, sale of assets and use of available cash. Accordingly, because the resulting ratio’s excursion from the norm will be transient and because the Company will be required to report to us quarterly on its efforts to make good on its representation that it will soon reestablish a more conventional capital structure, we are willing to approve this § 17A request.

As noted above, the Department has determined that, under G.L. c. 164, § 17A, a petitioner must demonstrate that its proposal is consistent with the public interest and that a petitioner would meet this standard if, upon consideration of all of the significant aspects of a proposal, the public is at least as well served by approval of the proposal as by its denial. See Bay State Gas Company, D.P.U. 91-165 (1992). The Department has further noted that the application of the public-interest standard in a § 17A case is based on the totality of what can be achieved by the proposal rather than a determination of any single gain (or loss) that might be derived from the proposed transactions. Id. After balancing all of the factors involved in

¹⁴ Specifically, the Company anticipates raising additional cash from the sale of the LNG assets currently held by Panhandle Eastern (SRR DTE-1-2). Financial projections estimate the sale of Panhandle’s LNG operations at an approximate price of \$550 million, which would include the assumption of \$284 million in debt by the purchaser (id.). The sale would both reduce debt on the consolidated balance sheet and generate approximately \$266 million in cash, of which \$207 million will be available to the Company for the repayment of debt (the difference belonging to AIG) (id.).

the investment together with the Company's proposal to recapitalize its balance sheet through the issuance of equity and other initiatives, the Department is persuaded that the investment causes no net harm to the ratepayers. Customers will be at least as well served by the Department's approval of the proposed investment as by its denial. Therefore, the Department approves the Company's request for approval under G.L. c. 164, § 17A.

B. Stock Issuance

1. "Reasonably Necessary" Standard

Southern Union states that the primary objective of its proposed issuance is to allow for the repayment of indebtedness for the purpose of strengthening the Company's consolidated balance sheet resulting from its acquisition of Panhandle Eastern (Exhs. SU-1 at 15; SU-8; SU-20; Company Brief at 7). Through the issuance of additional equity, the Company will repay long-term debt and redeem existing preferred securities to improve its debt-to-equity ratio and overall capital structure, as well as fund utility operations (Exh. SU-1, at 15-16; Tr. at 32).

The Department has found previously that issuing stock for the purposes of acquiring and maintaining equity is a "legitimate utility purpose" as contemplated by G.L. c. 164, § 14. Bay State Gas Company, D.P.U. 93-14, at 14 (1993); Colonial Gas Company, D.P.U. 90-50, at 6 (1990). Redeeming existing securities and funding utility operations is also a customary purpose of stock issuances. Berkshire Gas Company, D.T.E. 96-64, at 8-9 (1996); Berkshire Gas Company, D.T.E. 94-14, at 4, 9 (1994). Accordingly, the Department finds that the proposed issuance of not more than \$300 million in stock for the purpose of repayment of long-term debt and the redemption of existing preferred securities is reasonably necessary to

accomplish a legitimate purpose in meeting the Company's service obligations in accordance with G.L. c. 164, § 14, and therefore meets the first prong of the Department's two-prong standard.

2. Net Plant Test

In regard to the net plant test, the Department requires companies to demonstrate that their net utility plant equals or exceeds their total capitalization pursuant to G.L. c. 164, § 16 Colonial Gas Company, D.P.U. 84-96, at 5 (1984). Southern Union has proposed a number of adjustments to its actual capital structure to demonstrate that the proposed \$300 million stock issuance met the Department's net plant test. The Company has proposed to exclude CWIP from its plant investment balance and to exclude retained earnings from its capitalization (Exh. SU-4). The Department has found previously that CWIP and retained earnings should be excluded from a company's plant and capitalization accounts for purposes of the net plant test calculation. Southern Union Company, D.T.E. 01-52, at 9 (2001); New England Power Company, D.P.U. 92-189, at 7 (1992); Colonial Gas Company, D.P.U. 84-96, at 8 (1984). Accordingly, the Department finds that Southern Union's adjustments to exclude CWIP and retained earnings are appropriate.

Southern Union has proposed excluding unregulated property, plant and equipment in service and the capital used to finance those assets from the net plant test calculation. The Department finds that the Company has appropriately excluded its investments and capital associated with unregulated operations. Southern Union Company, D.T.E. 01-52, at 9-10 (2001); Southern Union Company, D.T.E. 01-32, at 10-11 (2001). See also NYNEX Price Cap, D.P.U. 94-50, at 440 (1995); Colonial Gas Company, D.P.U. 84-94, at 51 (1984).

Similarly, the Company has removed the book value of its Texas properties sold to ONEOK and increased its book value of operating property, plant and equipment acquired in the purchase of Panhandle Eastern (Exh. SU-4). Insofar as this plant is no longer owned by the Company, the Department finds that Southern Union has appropriately excluded its Texas operations from plant in service.

Similarly, the Company's proposed adjustment for acquisition premiums is appropriate, given that an acquisition premium, or goodwill, is intangible and, as such, should be excluded as a component in a utility's plant for purposes of G.L. c. 164, § 16. Southern Union Company, D.T.E. 01-32, at 11 (2001); New England Power Company, D.T.E. 00-53, at 8-9 (2000). Accordingly, the Department finds that the Company appropriately excluded its acquisition premiums from its capital structure.

The record demonstrates that, with the issuance and distribution of up to \$300 million in common and/or preferred stock, Southern Union's total capital stock and long-term debt will not exceed the Company's net utility plant following the stock issuance. Accordingly, the Department finds the Southern Union's issuance of \$300 million in preferred/common equity meets the net plant test as provided in G.L. c. 164, § 16. Taken in its entirety, the proposed acquisition of Panhandle Eastern and the associated stock issuance provide Southern Union with an opportunity to achieve a strengthened financial position.

As noted above, the actual amount and composition of the Company's stock financing are not known with certainty at this time, and will not be finalized until a date proximate to the issuance, based on market conditions, investor feedback, and general economic and political conditions (Tr. at 48-52; SRR DTE 2-1). The Department directs the Company to provide the

Department with the following information within 30 days of the successful issuance of each type of equity: (1) the type of security issued; (2) number of shares issued; (3) issuing price; (4) proceeds; (5) maturity date (where applicable); and (6) interest rate (where applicable). In addition, the Department directs the Company to file within thirty days of the sale of Southern Union Panhandle Corporation or Panhandle Eastern Pipe Line Company assets, a report describing the sale and stating the total amount of the proceeds together with the amount used for debt reduction.

Issues concerning the prudence of the proposed financing have not been raised in this proceeding, and the Department's decision in this case does not represent a determination that any project is economically beneficial to the Company or its customers. The Department's determination in this Order is not in any way to be construed as a ruling relative to the appropriate ratemaking treatment to be accorded any costs, including interest expense, associated with the proposed financing.

VI. ORDER

Accordingly, after due notice, hearing, and consideration, the Department:

VOTES: That the investment of up to \$662.3 million in Southern Union Panhandle Corporation by Southern Union Company is in the public interest as required by G.L. c. 164, § 17A; and

VOTES: That the issuance by Southern Union Company of common and/or preferred stock up to an aggregate value of \$300 million is reasonably necessary and is in the public interest as required by G.L. c. 164, § 14; and

VOTES: That the issuance of common and/or preferred stock by Southern Union Company up to an aggregate value of \$300 million meets the Department's net-plant test, pursuant to G.L. c. 164, § 16; and it is

ORDERED: That the investment by Southern Union Company of up to \$662.3 million in Southern Union Panhandle Corporation is approved and authorized; and it is

FURTHER ORDERED: That the issuance by Southern Union Company up to \$300 million of common and/or preferred stock is approved and authorized; and it is

FURTHER ORDERED: That within thirty days of the stock issuance, Southern Union Company file with the Department a report describing the composition and price of the issuance with regard to common and all types of preferred stock; and it is

FURTHER ORDERED: That within thirty days of the sale of Southern Union Panhandle Corporation or Panhandle Eastern Pipe Line Company assets, Southern Union Company shall file a report with the Department describing the sale and stating the total amount of the proceeds together with the amount used for debt reduction; and it is _____

FURTHER ORDERED: That upon completion of the Company's investment, approved and authorized under G.L.c. 164, § 17A, the Company shall, at the close of each calendar quarter, including the quarter in which the investment is made, report to the Department on the results of its effort to restore its capital structure ratio to the range of 60 to 65 percent debt and 35 to 40 percent equity until such restoration is accomplished or until the Department shall excuse further reporting; and it is

FURTHER ORDERED: That the Secretary of the Department shall within three days of the issuance of this Order cause a certified copy of it to be filed with the Secretary of State of the Commonwealth; and it is

FURTHER ORDERED: That Southern Union Company comply with all other directives contained in this Order.

By Order of the Department

Paul B. Vasington, Chairman

James Connelly, Commissioner

W. Robert Keating, Commissioner

Eugene J. Sullivan , Jr. Commissioner

Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).